

ST 03-0020-GIL 02/05/2003 EXEMPT ORGANIZATIONS

Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification "E" number. See 86 Ill. Adm. Code 130.2007. (This is a GIL.)

February 5, 2003

Dear Xxxxx:

This letter is in response to your letter to the Department dated October 15, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

In the following situation, please advise whether or not the service occupation tax on retail prescription drugs can be exempted:

A cooperative of AAA Districts in Illinois sponsor a self funded employee benefit plan that includes a drug card for prescription drugs. Employees use the drug card at the pharmacy to obtain their prescriptions. The employee pays a fixed copay at the store and the cooperative pays the balance through the drug card administrator.

In certain districts, employees pay a portion of their health insurance coverage through a payroll deduction.

If you have any questions or would like further clarification of the situation, please call.

Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification "E" number. See the enclosed copy of 86 Ill. Adm. Code 130.2007. This number evidences that this State recognizes that the organization qualifies as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purpose. Sales to a governmental body are subject to tax unless the governmental body has an active exemption identification "E" number. See the enclosed copy of 86 Ill. Adm. Code 130.2080. If an organization or governmental body does not have an "E" number, then its purchases from your company are subject to tax. Only sales to the organization or governmental body holding the "E" number are exempt, not sales to individual members of the organization.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax. The tax consequences of the transactions you describe depend upon many factors. We hope the following information is useful to you.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f) enclosed. This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. This class of registered de minimis servicemen also collects the corresponding Service Use tax from their customers absent exemptions. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers, nor are they liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

Most pharmacists are registered de minimis servicemen. (See the third method payment above.) These servicemen pay Service Occupation Tax based upon the cost price of tangible

personal property transferred incident to sales of service. They collect the corresponding Service Use Tax from their customers. If their customers are holders of an "E" number, the customer is exempt from paying the Service Use Tax, and the servicemen is exempt from paying the Service Occupation Tax.

In the situation described in your letter, the taxation of the drug purchases will depend upon to whom the drugs are sold. Your letter is not clear about this. If the drugs are sold to an organization that has obtained an "E" number from the Department, then the sale may be made free of tax. If the organization has not obtained an "E" number, then the sale cannot be made free of tax. Even were we to assume that the organization is exempt from tax, two separate transactions with different tax consequences occur in the situation you describe. In the first transaction, the pharmacist would make a sale to an exempt organization. In the second transaction, the pharmacist would make a sale to employees when they purchase drugs and remit a co-pay. The sale made to an individual employee—the co-pay transaction—is not exempt from sales tax. This is because the sale is made to an employee, not an exempt organization. It is improper for individual members of an exempt organization to use the organization's "E" number to make individual purchases.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

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Enc.